
**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

COMMONWEALTH EDISON COMPANY	:	
	:	
	:	
	:	
Petition for approval of delivery services tariffs	:	01- 0423
and of residential delivery services implementation :	:	
plan, and for approval of certain other amendments :	:	
and additions to its rates, terms and conditions.	:	

***PHASE II
BRIEF ON EXCEPTIONS OF THE STAFF
OF THE ILLINOIS COMMERCE COMMISSION***

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NOW COMES the Staff of the Illinois Commerce Commission (“Staff”) and pursuant to Section 200.830 of the Illinois Commerce Commission Rules of Practice (83 Ill. Adm. Code 200.830), respectfully submits this Phase II brief on exceptions to the Administrative Law Judge’s (“ALJ”) Proposed Order issued on March 21, 2003. Please note that in preparing a Brief on Exceptions within the time allotted by the schedule that was implemented as of March 19, 2003, it was generally necessary for Staff to limit its consideration to those statements in the Proposed Order (“PO”) that are erroneous, either in that they misapprehend or mischaracterize Staff’s position or testimony, or otherwise.

I. EXCEPTIONS

Certain statements in the PO are erroneous and need to be corrected. The fact that Staff has limited its exceptions to these types of exceptions should not be construed as an endorsement or acquiescence to the PO. As Staff has previously stated the schedule in this matter is similar to one the Illinois Supreme Court found to “skirt[] the edge of a due process violation” in *Business and Professional People for the Public Interest v. Illinois Commerce Commission*, 136 Ill. 2d 192, 555 N.E.2d 693, 144 Ill.Dec. 334 (1990).). In addition to the identification and suggested elimination of errors in the proposed order, Staff suggests one additional series of changes to the PO that are intended to reinforce ComEd’s commitment to continue to track and record separately the unamortized balance and annual amortization of original debt discount and premium.

- A. The Proposed Order is misleading with respect to Staff's position on the time value of money issue and uses hindsight to support the conclusion regarding that issue.

Argument

Staff takes exception with the language of the PO that states at page 63 that "In addition, Liberty did not adjust its capital smoothing analysis to take into account the fundamental economic principle of the time value of money, which ComEd witnesses Kamien and Jacobs, as well as Staff witness Bruce Larson, agree must be taken into account."

In his direct testimony, Staff witness Larson testified that the time value of money should be considered. However, in rebuttal he stated that the proper test to use is to select the alternative with the lowest revenue requirement subject to several constraints. The most basic constraint is the provision of reliable service. The National Electric Reliability Council defines several constraints, the most critical of which is to be able to serve load with the outage of a single device, such as a single transformer or transmission line. The important point is that the present value of an alternative that does not meet the reliability constraint is irrelevant. For example, the lowest cost alternative would be to spend nothing, but that alternative cannot meet the reliability constraint. Staff Ex. 33, p. 6. The PO should be changed because it is misleading in its current form.

Furthermore, the PO uses classic hindsight to support the following statement starting on page 63 “This finding goes only to the prudence and reasonableness of ComEd’s expenditures and investments” (PO, p. 63). In addition, the PO mischaracterizes ComEd witness Morris Jacobs’s testimony to support that same finding. Throughout its testimony, ComEd claimed that Liberty made grievous errors by using hindsight to reach the various findings in its audit report. ComEd witnesses testifying about the issue included: Arlene Juracek (ComEd Ex. 100.0); Karl A. McDermott, (ComEd Ex. 102.0); Ron Williams (ComEd Ex. 104.0); Morris Jacobs, (ComEd Ex. 106.0); Dr. James B. Williams (ComEd Ex. 108.0); Michael F. Born, P.E. (ComEd Ex. 109.0); Kathryn M. Houtsma, CPA (ComEd Ex. 110.0) and Jerome P. Hill, (ComEd Ex. 112.0). Yet the PO uses hindsight when it states “ When the time value of money is taken into account, the evidence shows that Liberty’s proposal to move \$270 million of ComEd’s 1999-2000 capital investments back in time to the 1993-1998 period actually increases costs by at least \$35 million” and “this finding goes only to the prudence and reasonableness of ComEd’s expenditures and investments” (PO, pp. 63). The PO improperly finds that a time value of money argument proposed by ComEd witness Jacobs (ComEd Ex. 106.0, p. 3) supports a finding that ComEd was not imprudent in its expenditures and investments. (PO, p. 63) A review of the record in this proceeding demonstrates that ComEd never offered any evidence in the record in this proceeding showing that back in 1993 through 1998 ComEd performed a time value of money analysis similar to Morris Jacobs and used such an analysis to determine that it would be cheaper to postpone those capital investments to 1999 and 2000. The PO ignores the sacred principal argued by ComEd witness Jacob’s and several other

ComEd witnesses that “Only information that was known or reasonably should have been known by the decision makers can be considered.” (ComEd Ex. 106.0, p. 7)

Given that ComEd offered no evidence showing that this type of analysis was done back in 1993 and that ComEd relied upon such an analysis to reach a decision to postpone investments, it is incorrect for the PO to take the position that the time value of money analysis supports a finding that ComEd acted prudently and reasonably with respect to capital investment made in 1999-2000.

Proposed Modification
(PO, p. 58)

* * *

Bruce A. Larson, P.E. (Staff Exhibit 33) testified to his review of ComEd’s critique of the Liberty audit and responded to portions of the additional direct testimony of ComEd witnesses Ms. Juracek, Mr. Born, Mr. Jacobs, Mr. Donahue and Dr. Williams. With respect to the time value of money issue, Mr. Larson testified that the proper test to use is to select the alternative with the lowest revenue requirement subject to several constraints. The most basic constraint is the provision of reliable service. The National Electric Reliability Council defines several constraints, the most critical of which is to be able to serve load with the outage of a single device, such as a single transformer or transmission line. In other words, the present value of an alternative that does not meet that constraint is irrelevant. For example, the lowest cost alternative would be to spend nothing, but that alternative cannot meet the reliability constraint.

* * *

Proposed Modification
(PO, p. 63)

* * *

~~In addition, Liberty did not adjust its capital smoothing analysis to take into account the fundamental economic principle of the time value of money, which ComEd witnesses Kamien and Jacobs, as well as Staff witness Bruce Larson, agree must be taken into account. When the time value of money is taken into account, the evidence shows that Liberty’s proposal to move \$270 million of ComEd’s 1999-2000 capital investments back in time to the 1993-1998 period actually increases costs by at least \$35 million, even taking into consideration Liberty’s allegation that approximately \$49 million of “excess” overtime, expediting and project mismanagement costs were incurred to complete the work in 1999-2000. While, as indicated above, Liberty~~

~~presented the factors it relied upon for taking a different view, we disagree with Liberty's view that such an adjustment for the time value of money is inappropriate in this instance. We conclude, based on the specific circumstances and evidence presented here, that such an adjustment is proper. Of course, rejecting this proposed adjustment in part on this basis does not weaken in any way the obligation of utilities to take prudent action to provide adequate and reliable service, which is discussed above. Nor does rejecting this proposed adjustment mean that the Commission is absolving ComEd of any failures it may have had to maintain the integrity and reliability of its distribution system. This finding goes only to the prudence and reasonableness of ComEd's expenditures and investments.~~

~~* * *~~

Proposed Modification
(PO, pp. 64-65)

~~* * *~~

~~Finally, even if Liberty were correct that \$42.6 million of "excess" costs were incurred on ComEd's 1999-2001 construction projects, it does not support a capital disallowance on the basis of an alleged increase in the utility's rate base. The time value of money analysis prepared by ComEd witness Morris Jacobs demonstrates that, even if such "excess" costs were incurred, the cash flows from ComEd's actual construction schedule are significantly more economical than the cash flows from Liberty's alternative hypothetical 1993-1998 construction program. Again, we disagree with Liberty regarding the applicability of Mr. Jacobs' analysis to the particular facts presented in this case.~~

~~* * *~~

B. Retirements Related to 2001 Replacement Plant

Argument

The text of the PO contains an incorrect amount on page 43. The PO indicates that the adjustment to depreciation expense associated with the adjustment for plant retirements related to 2001 replacement plant is \$279,000. However, the adjustment shown in the schedules attached to the PO reflects this adjustment as \$277,000. The text of the PO should be modified to reflect the \$277,000 amount.

Proposed Modification
(PO, p. 43)

* * *

Staff proposes an \$11,060,000 adjustment to reflect the retirement of old plants that will be replaced by new plants, and that will be placed in service during 2001. Staff also states that the adjustment to jurisdictional net plant in service is zero. Staff also proposes an adjustment to decrease the associated depreciation expense by ~~\$279,000~~\$277,000. ComEd accepts Staff's proposed adjustment, including the analysis of no net impact on plant in service.

* * *

C. Accumulated Deferred Income Tax Effects

Argument

The text of the PO contains an incorrect amount on page 65. The PO indicates that the adjustment to accumulated deferred income taxes is \$1,156,000. However, the adjustment shown in the schedules attached to the PO reflects this adjustment as \$1,136,000. The text of the PO should be modified to reflect the \$1,136,000 amount.

Proposed Modification

(PO, p. 65)

* * *

Notwithstanding the foregoing, in order to narrow the issues in this proceeding, the testimony of ComEd witness Jerome Hill supports, and the Movants, including ComEd, do not oppose the inclusion of the following rate base adjustments proposed by Liberty: a \$1,890,000 pro forma to actual "true up" adjustment as of June 30, 2001 (reducing the Interim Order's \$11,038,000 adjustment by \$1,890,000 to \$9,148,000), a \$2,418,000 Northwest Project adjustment, a \$917,500 adjustment to Emergency Work Order projects, a \$128,371,000 unrecorded retirements adjustment and a \$123,821,000 new depreciation method adjustment. Each of these adjustments and the effects thereof (including accumulated depreciation adjustments of \$254,358,000, as well as an accumulated deferred income tax adjustment of ~~\$1,156,000~~\$1,136,000) are reflected in Appendix A to this order and the Commission approves each of these adjustments.

* * *

D. Depreciation Expense Adjustments Resulting From Liberty Audit

Argument

The text of the PO contains an incorrect amount on page 121. The PO indicates that the adjustment to depreciation expense resulting from the PO's acceptance of

certain Liberty Audit Report adjustments is \$8,147,000. However, the adjustment shown in the schedules attached to the PO reflects this adjustment as \$8,526,000. The text of the PO should be modified to reflect the \$8,526,000 amount.

Proposed Modification
(PO, p. 121)

The Commission agrees with GCI's and Staff's position. The adjustment is beyond the scope of Liberty's audit. In addition, ComEd's change in its depreciation rates took place well after the close of the 2000 test year. To make any determination in this Order regarding the July 2002 filing, which is not even before us, would implicate the concerns underlying the temporal limitations on *pro forma* adjustments and would be inappropriate. Accordingly, the Commission rejects Liberty's proposed downward adjustment in depreciation expense, and approves only the remaining ~~\$8,147,000~~ \$8,526,000 of depreciation expense adjustments resulting from the Audit Report reflected on Appendix A. These findings are not and should not be understood as making or relying upon any determination regarding the new depreciation study filed in July 2002 and the rates therein. As stated above, that study is not before the Commission in this Docket. The Commission has not made and need not make any finding under Section 5-104 of the Act regarding the new depreciation study filed in July 2002 and the rates therein. Such a finding is beyond the scope of this proceeding and there is no basis in the evidence in the record to make any such finding. Thus, this Order does not constitute a determination regarding the appropriateness of the new depreciation study filed in July 2002 and the rates therein. Nothing in this Order should be relied upon to constitute a determination regarding any rates that may be proposed for use after the transition period.

- E. ComEd Commitment to track and record treatment of original debt discount and premium

Argument

During Phase I of the proceeding, Staff and ComEd initially disagreed about whether purchase accounting adjustments should be reflected in the cost of debt.

(ComEd IB, December 10, 2001, p. 98; Staff IB, December 10, 2001, pp. 74, 76)

However, as part of an overall resolution of the cost of capital issue, ComEd agreed to continue to track and record separately the unamortized balance and annual

amortization of original debt discount and premium. (ComEd IB, December 10, 2001, p. 98) Staff believes the Commission should accept ComEd's offer, memorialize it in the Final Order, and make it a requirement of the Commission's Order. This will ensure that the Commission will have the original debt discount and premium data should it decide in a future rate proceeding that ComEd's purchase accounting adjustments to that data should not be reflected in ComEd's cost and balance of debt for the purpose of setting rates. Therefore, Staff recommends adding the following to the Order.

Proposed Modification
(PO, p. 126)

* * *

2. Cost of Debt

Staff recommends a 6.95% cost of long-term debt. ComEd accepts Staff's proposal, as does GCI. Although ComEd made purchase accounting adjustments to the balance and annual amortization of debt discount and premium for its financial statements, ComEd has agreed to continue to track and record separately the unamortized balance and annual amortization of original debt discount and premium in the event that the information is needed for use in future rate cases.

The ARES Coalition initially introduced testimony concerning allocation of debt costs between the supply business and the delivery business, but that testimony has been withdrawn.

Commission Analysis and Conclusion

The Commission finds that the evidence in the record supports the 6.95% cost of long-term debt proposed by Ms. Freetly. The Commission concludes that the cost of debt proposed by Ms. Freetly includes no differing debt costs between the supply business and the delivery business. The 6.95% cost of debt calculated by Ms. Freetly takes into account only debt that supports the delivery services business and therefore is the cost of debt to ComEd as a delivery services company. The 6.95% cost of long-term debt proposed by Ms. Freetly is reasonable and is approved. The Commission also accepts ComEd's offer to continue to track and record separately the unamortized balance and annual amortization of original debt discount and premium in the event that the information is needed for use in future rate cases.

Proposed Modification
(PO, p. 152)

Add the following ordering paragraph.

IT IS FURTHER ORDERED that ComEd continue to track and record separately the unamortized balance and annual amortization of original debt discount and premium in the event that the information is needed for use in future rate cases.

II. CONCLUSION

WHEREFORE, for the reasons set forth above, the Staff of the Illinois Commerce Commission respectfully requests that its modifications to the Administrative Law Judges' Proposed Order be adopted.

Respectfully submitted,

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